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TITLE INSURANCE: STATE REGULATION AND THE PUBLIC PERSPECTIVE *

E. F. Roberts†

The nature of regulation now in force at the state level and applicable to title insurance companies is such that the industry is not adequately regulated. Such a conclusion can mean two different things. On the one hand, it can mean this particular segment of the insurance industry is not immune from federal regulation under the provisions of the McCarran-Ferguson Act. On the other hand, it can mean that the public is not being adequately protected by the insurance laws of the several states when it purchases title insurance. Suffice to say, this conclusion includes both meanings within its scope.

It is the purpose of this article to illustrate only one aspect of the problem, namely, the protection of the public as purchasers of title insurance. In order to illustrate why the current insurance codes are inadequate, however, it will be necessary to examine the nature of the title insurance industry itself. Further, it will become evident that before the changes in regulation which are necessary to protect the public can be initiated, certain other questions must be answered. Briefly, assuming reform is needed, where does the Bar fit into the picture, since it has a stake in the problem; and where do the new lawyers’ guarantee funds fit in any new regulatory structure? It should also become clear that the real problems involved in regulating the title insurance industry cannot be solved simply by manipulating clauses in an insurance

* The thoughts contained in this article were put together while the author was a visiting professor at the University of Nottingham. Looking back at the American scene from the vantage point of a jurisdiction in which an efficient system of land registration is in vogue one may wonder whether an English conveyancer didn’t hit the nail on the head when he observed: “It appears to me that you people are about two hundred years behind the times.” Be that as it may one must deal with the situation as it is and proposed reforms must fall within at least the penumbra of the attainable; it is assumed, therefore, that some form of title insurance is here to stay, at least for the foreseeable future.

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code. This is so not merely because the title insurance device is inex-
tricably interrelated with the conveyancing processes by which real
estate is transferred from one owner to another, but because that device
serves as a vital cog underpinning the national mortgage market. The
effects of tinkering with the insurance laws must be viewed, therefore,
in light of the possible effect on the whole financial structure revolving
around investments in real property.

THE NATURE OF TITLE INSURANCE

Title insurance does not insure the policyholder against the risk
that sometime in the future a defect may arise which will detract from
the insured's title to real property. Instead title insurance is designed
to protect the insured against the day when it is discovered that a defect
already existed in the title to real property at the time it was insured.
Assuming, therefore, that a particular title to real estate is perfect when
it is insured, it follows that the title insurance company undertakes no
risk at all loss wise when it insures this piece of real
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It must
also be borne in mind that the company is liable to the insured only for
actual losses suffered by him as the result of a subsequently discovered
defect in his title: the undertaking of the company is perforce one of
indemnity. Further, the company's liability for losses is limited to the
face amount of the policy.3

Counterpoint to these limitations upon the insurer's liability are
two factors which must be interpolated into the title insurance equation

2. "The risks of title insurance end where the risks of other kinds begin. Title
insurance, instead of protecting the insured against matters that may arise during a
stated period after the issuance of the policy, is designed to save him harmless from
any loss through defects, liens or encumbrances that may affect or burden his title when
he takes it." Trenton Potteries Co. v. Title Guar. & Trust Co., 176 N.Y. 65, 72, 68
N.E. 132, 134 (1903). Accord, Froehrenbach v. German-American Title & Trust Co.,
217 Pa. 331, 66 Atl. 561 (1907). For definitions of title insurance see 1 RICHARDS, INS-
SURANCE § 32 (5th ed. 1952) ; Pelkey, The Law of Title Insurance, 12 MARQ. L. REV. 38,
42-43 (1927).

3. In rare instances it is possible to sue the insurer for negligence, quite apart from
the policy of insurance, and thereby avoid this limitation on liability. This happens most
often in cases where the company runs the search and examination of the title as a ser-
vice distinct from the issuance of the insurance policy. E.g., Henkels v. Philadelphia
Title Ins. Co., 177 Pa. Super. 110, 110 A.2d 878 (1955). In order to avoid this contingen-
cy most insurers now impose a single charge for all the services rendered, and
the new American Title Association policy forms contain a clause limiting the rights of
the insured to the policy. "Any action or actions or rights of action that the insured
may have or may bring against the Company arising out of the status of the title ins-
ured herein must be based on the provisions of this policy." Public Regulation of
TITLE INSURANCE COMPANIES AND ABSTRACTERS 328 (Roberts ed. 1961). But see Kess-
ler, Contracts of Adhesion—Some Thoughts About Freedom of Contract, 43 COLUM. L.
REV. 629 (1943). For a fine survey of the cases and the problems involved in this area
see Note, Title Insurance: The Duty to Search, 71 YALE L.J. 1161 (1962).
before one can arrive at a value judgment about the efficacy of such insurance. First, the company undertakes to defend the title as insured against adverse claims and, as a rule, the companies have proved to be tenacious litigants. Even if the company is successful in defending the title, that is, even if the title does prove to be perfect, the company must bear the costs of the legal quarrel. Thus even a no-loss-risk title involves a potential risk of claim expenses. Second, there is no precise term cutting short the time during which the company continues to be liable to indemnify and/or defend the insured. The statute of limitations on claims for indemnity by the insured does not begin to run until he has actually suffered a loss attributable to a defect in the title. At best, therefore, the company can hope that the operation of the doctrine of adverse possession will protect the insured against most losses after the expiration of the typical twenty year period.

The losses against which the insured is protected by title insurance fall into two classes. First, just as with the lawyer-conveyancer, the search may have been inadequate or the examination of the abstract may have been faulty. Surprisingly, most claims against title insurance companies arise because of these errors. Whereas the lawyer-conveyancer would be liable in tort for losses resultant from such oversights or errors only if he had been "negligent," the title insurance company is liable on elementary contract principles. Second, quite unlike the lawyer-conveyancer, the title insurance company is liable to indemnify the insured for losses arising out of defects not a matter of record, or if of record, of such a nature that they could not reasonably be expected to have been discovered by a thorough search of the local

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5. "In the case of a small policy, the expense of defending the title is sometimes greater than the amount of the policy." Davenport, op. cit. supra note 4, at 310.
7. The experience of my company—and we have an accumulated policy liability of 79 years—is that over eighty percent of our losses arise within five years of the policy date and 90% within ten years but that we occasionally have losses which arise more than 25 years after the assumption of the risk. Only this year we paid a sizeable loss on a policy which was written before World War I—over 50 years ago. The property had not changed hands in the interim and adverse possession did not help us much as to marketability because there was absolutely no color of title to a portion of the land.
8. "More losses result from the negligence of company employees and agents than from any other cause; negligent failure to note unpaid taxes, restrictive covenants, easements and judgments have proved particularly troublesome." Johnstone, supra note 4, at 502. See Burlingame, Experience in Losses and Claims, Eastern Area, Title News, Dec. 1953, p. 66.
record depositories. These are the "hidden defects" not protected against by conventional conveyancing techniques, including such things as forgeries, unknown heirs, and marriages not of local record.\(^9\)

Another thing that must be considered is the fact that a title insurance company will except from coverage any obvious defects which it discovers in the title. This is the root of the often heard charge that "title insurance insures against nothing." True enough if title insurance was casualty insurance, but it is not: the whole point of title insurance is to afford protection against only the errors and omissions of the traditional conveyancing process and against hidden defects which escape discovery by even the best searches. It supplements the traditional search and examination of record title; it does not do away with the system.\(^10\)

How does title insurance add to or subtract from the conventional protection afforded the vendee of real estate? If the vendee does suffer a loss, he can be certain of being indemnified without proving negligence.\(^11\) At the same time, unlike a claim for negligence, the amount of the recovery is limited by the face amount of the policy. The insured must be careful, therefore, to acquire more insurance if he makes improvements or simply to make allowances for inflation. Curiously enough, not even the companies themselves advertise this fact. The vendee, moreover, is protected against losses attributable to hidden defects, a total departure from traditional techniques. While rather disastrous if and when they do occur, it must be admitted that such claims are rather rare.\(^12\) Most significant, perhaps, is the fact that the company undertakes to defend the title as insured: in effect, if nothing else, the vendee has retained a powerful champion against the day a potential adverse claimant appears.

9. For an extensive list of hidden defects see Public Regulation of Title Insurance Companies and Abstracters 7 n.6 (Roberts ed. 1961). Some of these defects are automatically excluded from coverage by the general clauses found in nearly all contracts.

10. "It cannot be said dogmatically, then, that title insurance is not true insurance; rather it should be said that title insurance represents a series of services, the reliability of which is guaranteed by the performer." Gage, Land Title Assuring Agencies in the United States 130 (1937).

11. See also note 3 supra.

12. The protection afforded by the lawyers' opinion system is almost as great as that provided by title insurance, if competent lawyers and abstracters are used. The added protection of title insurance covers only remote risks, although the losses can be heavy if they do occur. Abstracters and lawyers are liable in tort for their negligence, but it is difficult to secure a judgment against a lawyer for negligence in examination. . . . But even though they keep lower reserves than other insurance companies, title insurance companies are better able financially to pay losses than are abstracters and lawyers, and they are more likely to be in existence when the losses occur.

Johnstone, supra note 4, at 498.
Given the prevailing insurance premium of $3.50 per thousand dollars coverage, the costs of protection can be rationalized by spreading them out over the typical twenty year period during which adverse protection arguments are most generally unavailable to the vendee. Taking this approach the protection afforded by title insurance costs seventeen cents per thousand per year during this particularly vulnerable period. Even though the protection afforded by title insurance is only minimally higher than that afforded by traditional techniques, the extra charge is itself commensurate with the added increment of protection. Title insurance is probably worth the money, but only marginally so as far as the vendee is concerned. This rather lukewarm conclusion instantly raises the real problem: how is it then that the title insurance industry has become the multimillion dollar enterprise that it is today?

The Development of Title Insurance

In the air-conditioned executive suites of the largest title insurance company in Philadelphia one may still hear recited, Beowulf-wise, the conventional genesis of title insurance. According to this tale many lay conveyancers were operating in Philadelphia after the Civil War, these laymen carrying on a tradition that arose during colonial days when a shortage of lawyers caused literate members of the community to assume the conveyancer’s function. Be that as it may, in the year

13. The premium for title insurance is paid once—when the policies are issued. In practice the vendee pays the premium for both his own policy and the mortgagee’s policy. If the insurance is obtained through an approved attorney, this premium is the only charge made by the insurer. In those cases where the insurer handles the conveyancing as well, a single charge is imposed which includes the premium as only a part of the total charge.

Each time a house is sold, of course, the new vendee must obtain his own title insurance policies for himself and his mortgagee. In the case where the insurer is also the conveyancer, the frequent turnover of the ownership of property increases the insurer’s profits on conveyancing. This is so because the insurer has on file the results of its original search and examination of the title and now it needs only to bring these up to date, charging the same rate for the packaged insurance and conveyancing services. Should the mortgage be assigned, however, the original lender’s policy covers subsequent assignees. This accords with the idea that title insurance expedites the negotiability of mortgage portfolios and, concomitantly, with the suggestion that the interests of the owner-class are not necessarily represented by the lenders in negotiations vis-à-vis title insurance protection. Compare American Title Association Standard Loan Policy—Revised Coverage—1960, which provides that the “insured” includes “each successor in interest” in the ownership of the mortgage indebtedness, with American Title Association Owner’s Policy—Standard Form A—1960, which limits coverage to the “Insured, the heirs, devisees and personal representatives of such Insured,” omitting subsequent purchasers from the insured. Public Regulation of Title Insurance Companies and Abstracters apps. A, B (Roberts ed. 1961).

14. Ibid.

15. E.g., LaBrum v. Commonwealth, 358 Pa. 239, 56 A.2d 246 (1948). “From the earliest days in this Commonwealth, justices of the peace, aldermen and local magistrates have drawn and still continue to draw leases, deeds and mortgages without hold-
1867 one Watson, a vendee, brought an action of negligence against Muirhead, a lay conveyancer. Watson had recently purchased an interest in real estate, and Muirhead had searched the title for him and had approved it. The title was not free and clear, however, and the execution of a judgment of record shortly wiped out Watson's purchase. Muirhead had been aware of the judgment but he had relied in turn on the opinion of "Eminent Counsel" that it was not a final one. To make a long story short, the highest court of Pennsylvania ultimately ruled that Muirhead owed Watson the duty of reasonable care, thereby equating lay conveyancers and lawyers, and, further, that Muirhead had proceeded reasonably, relying as he did on counsel's advice.¹⁶

Convention has it that this decision shocked the conscience of both bench and bar in Philadelphia, revealing as it did a glaring defect in the conveyancing system. That is, absent recourse against the vendor on warranties, the vendee was forced to suffer the entire loss should an adverse claimant appear upon the scene after the vendee's conveyancer had, in the exercise of due care, advised vendee that the title was free and clear. Shocking as this may be, it is somewhat difficult to imagine why it should have upset the bench and bar in the nineteenth century when, after all, this result was axiomatic in any common law jurisdiction.

More pertinent may have been the fact that Philadelphia was preparing for its Centennial Exposition of 1876 and that a land boom was anticipated. Relevant also was the fact that the public record system pertaining to land in Philadelphia was in an appalling state.¹⁷ As chance would have it Watson v. Muirhead¹⁸ warned potential land buyers off lay conveyancers just at this moment. In this situation an early critic of title insurance speculated that:

The effect of this selective process was to centralize the bulk of the conveyancing business into fewer and stronger hands. The added volume of orders, concentrated in a few

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¹⁷. It was necessary to search records in ten different offices, and in instances, the searching was done by public officials in these offices rather than by the conveyancer himself. The responsibility of the public officials by statute did not extend beyond five years from their term of office. Thus the abstract based upon name indexes from ten different offices, compiled by a variety of searchers including the conveyancer, was a rather risky document to rely upon for title protection in light of the Watson v. Muirhead decision.
¹⁸. 57 Pa. 161 (1868).
law firms, created a precarious situation. The conveyancers had no way of speeding up the assuring process without shortening the searching operation and taking upon themselves incalculable risks. This condition, and perhaps the astuteness of the "Philadelphia lawyers," led a group of progressive conveyancers to band together, pool their resources, and establish in 1876 the Real Estate Title Insurance Company.\textsuperscript{19}

Thus was the title industry the product of improvisation in the face of crisis. Granted that Gage’s speculations quoted above are more in accord with reality than the conventional myth, it remains to be seen why a device developed to solve a Philadelphia problem should have been adopted elsewhere.

Before the First World War title insurance had spread to other cities like New York, Washington and Chicago. Convention again has an explanation, this one turning on the point that the "hidden defect" protection afforded by title insurance made it preferable to older techniques. Once again the most likely explanation is to be founded on other reasons. The public record depositories in many large cities were completely out of date. Decades old in both facilities and techniques, these record centers were becoming a stumbling block to efficient conveyancing. In the urban centers, given the time needed to search titles, conveyancing was ceasing to pay its way in large law firms. Concomitantly, given the fact that conveyancing had become a profitless chore, the industrial development was creating new types of business for lawyers. As a result conveyancing simply atrophied in the urban firms. Title insurance companies, needless to say, were more than willing to take over conveyancing and create their own efficient record systems—their "title plants"—in lieu of the delapidated public ones.

This situation, however, was only a condition. Had there been no title companies, other expedients, such as reform of the public record centers, would have had to have been found. As it was title insurance tied in with lending money and it has been suggested that: "A powerful factor in the growth of the New York companies was their early combining with the evidencing of titles the lending of money on mortgage; the two businesses so supplemented each other as to give dominating positions in both fields."\textsuperscript{20}

\textsuperscript{19} Gage, \textit{op. cit. supra} note 10, at 81.
\textsuperscript{20} Viele, \textit{The Problem of Land Titles}, 44 Pol. Sci. Q. 421, 430-31 (1929). This article affords another excellent description of the chaotic conditions present in the public record systems.
Thus, title insurance from the start was part and parcel of the financing aspect of real estate transactions. In Pennsylvania title insurance again was part and parcel of the banking industry, almost every bank having its own title department. Whereas in New York City the title insurance phase of banking may simply have been a lucrative sideline, in Pennsylvania title insurance was a device used to get around restrictive banking laws which limited the number of banks in any given area. This was done by opening a title company, which had the ancillary power to lend money and accept deposits, the "Title and Trust Company" shortly becoming a standard feature of the Pennsylvania scene.\(^2\)

Title insurance was still relatively unimportant, however, until the boom following the First World War. It was then that the demand for money outstripped the local supply and that the institutional investors, particularly the growing life insurance companies, entered the picture. Able and eager to invest in real estate mortgages these institutional investors faced a serious problem: how were they to know how good the title to their security was? Dealing on a national scale, with a tremendous volume, either these investors had to know the reliability of thousands of local conveyancers or had to run their own searches. Either alternative being impracticable, these institutional investors began to demand title insurance as a condition precedent to their lending money on the security of real property.\(^2\)

This development marked a new era in conveyancing techniques in the United States. When the mortgage market became a nationwide affair, title insurance became the imprimatur which made a mortgage negotiable in this new market. It did so because the lender did not have to worry about thousands of local lawyers: it had only to keep track of a relatively few other insurance companies. Better yet, these companies were liable to make good any loss of the security regardless of negligence, and, unlike lawyers, they were corporate entities, which seemed to be assurance that they would neither die nor become insolvent. Best of all, since the buyer paid for the title insurance, protecting the respective interests of both the buyer and the lender, the service cost the institutional investors nothing.

Thus it was that a consumer was found for title insurance and the

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21. GAGE, op. cit. supra note 10, at 117 n. 4.
22. Ford, How California Went Title Insurance Over Night, in Proceedings, American Title Association (1932); Payne, In Search of Title, 14 ALA. L. REV. 11, 37 n. 82.
industry began to prosper. In urban centers the title companies began to take over conveyancing and the whole conveyancing process was centered in the companies' offices. Their records of past searches being kept on file and efficiently indexed, the title companies had to use the public records only in order to keep their data up to date. The burden on the public records was thereby lightened considerably, and, in lieu of modernizing the public records, privately owned modern plants were created. Able to institute electronic data processing and to apply assembly line principles to the search and examination aspects of the real estate transaction, title insurance companies were able to make conveyancing pay. Given the other avenues of business opened up by the boom period the lawyers hardly noticed the loss of the conveyancing trade. Further, the problem of losses attributable to errors in the conveyancing process had been socialized, the costs of these losses being spread by the insurance device across the property-purchasing public, to the intense relief of the investors in mortgage loans.

Thus far the title insurance story has been an urban one. With the advent of the national mortgage market, however, title insurance became a national institution itself. Conveyancers outside the megalopolis on each coast were used to put title insurance into every state. This was done when certain conveyancers, who met the companies' standards, were authorized to commit the companies to insure titles after these lawyers had completed their routine conveyancing work. Thus, in this instance, title insurance was used specifically to supplement the traditional conveyancing process, the companies dealing only in insurance and the lawyers handling the entire conveyancing routine in the standard manner. This allowed the urban conveyancing and insurance companies to reap additional "pure" insurance income from suburban and rural areas, and, at the same time, gave certain "approved attorneys" an edge over their competitors. This edge consisted of the fact that their imprimatur provided access to the institutional investors for mortgage money.

23. The size of this particular consumer is staggering. These institutional investors hold eighty per cent of the national non-farm real estate mortgage debt. For a ready set of figures, only now growing obsolete, see Johnstone, supra note 4, at 502 n. 39.

24. The use of title insurance by large lenders is somewhat curious because title losses are quite small and self-insurance might be considerably cheaper. I rather suspect that the real reason is that the institutional (and other) lender is not particularly concerned with a cost which is paid for entirely by the mortgagor and which admittedly gives the mortgagee some additional protection.

Payne, supra note 22, at 37 n. 82.

25. The Lawyers Title Insurance Corporation, for example, operates on this principle for the most part. In theory this kind of title insurance company makes no in-
As part and parcel of the greed enthroned during the twenties a new idea was born: mortgage insurance. That is, companies were formed which, for a premium, insured the lender against the risk that the mortgagor would default on his installments or, worse, on the principal itself. A feasible idea granting a permanent inflation, the idea was a patent absurdity given a crash. Nonetheless a number of new "title insurance companies" were formed in many states, particularly New York, again because title insurance companies possessed the power to insure mortgages. The result was disastrous. In New York, for example, of the forty new title insurance companies founded during this period, thirty-one had to be taken over for rehabilitation after the crash and all of these companies were eventually liquidated.3

It was during the Great Depression that, naturally enough, the several state legislatures began to enact statutes regulating the title insurers. New York, perhaps because it was hardest hit by the mortgage insurance disaster, took the lead in this reform. This reform legislation had a pattern, however, which was common to a number of states. First, jurisdiction over title insurers was vested in the insurance department and certain financial safeguards were set up. Indeed, it shortly became impracticable for banks to continue operating their title departments as integral units of the banks themselves; so these departments were set up as title insurance companies per se, the stock, of course, being retained by their parent banks. Title insurance and banking were separated operationally, albeit not ownershipwise.2 Second, title insurance companies incorporated after the new legislation were forbid-[dependent examination of titles; it simply relies on the reports of the examining attorney. Even a staunch opponent of title insurance companies admits that "if this were the only kind of title insurance it would have little significance except insofar as some additional safety at considerable additional expense is obtained." Payne, supra note 22, at 37. But see text accompanying note 46 infra.


27. The real control of title insurance companies remains a mystery. Since many title companies were created by incorporating trust company title departments, it has been assumed that the trust companies have maintained control over the stock of these companies. But the growth of the industry has required further stock sales in order to broaden the capital base in light of the enormous volume of liabilities assumed in recent years. Thus stock in many title insurance companies is now commonly sold "over the counter." This trend would indicate that the companies may be in the process of becoming independent entities, or it may mean that they have become so large that the banks can maintain control with less than a majority of the shares. The increased activity in the purchase and sale of title insurance company stock seems confirmed recently by a new investment guide specifically addressed to a study of the industry as an investment opportunity. See an advertisement on this point in Title News, July 1963, p. 27.
den to write other lines of insurance, particularly mortgage guaranty insurance. Third, having created a set of title insurance companies, now sui generis, the states applied economic controls which were designed to insure the continued solvency of these companies.

Looking across the vast statutory maze of fifty insurance codes it is possible to see a broad pattern to the financial controls imposed on the industry. Constructing a typical code representing a fair image of this legislation is probably the most expedient way of approaching the problem since no two codes are exactly alike. Such a code would center on the requirement that the company have a minimum paid-in capital of $250,000 and a paid-in surplus of $125,000. In theory, therefore, the company has assets available out of which policyholders may expect to exact payment in the event of claims arising against the company. In addition to these assets the company must, under the typical code, create a reserve of a percentage of premium income. This fund must be set aside to protect against the day that claims might wipe out all the other assets of the company, at which time it could be used to purchase reinsurance for the policyholders who did not as yet have claims.

On the surface the regulations appear to be adequate since the loss experience of the companies is such that no one in the regulatory agencies seems to have taken seriously the idea that a hidden defect might occur leading to a total loss. In fact, experience to date indicates that the actual losses incurred by title insurers involve petty matters overlooked by their own searches. These overlooked charges on the land are simply paid off by the insurer as a matter of course. So insignificant are these claims in fact that the actual loss experience nationwide was recently calculated to be 1.69 per cent of premium income! Presuming the accuracy of this calculation and discounting the idea that

28. N.Y. Ins. Laws §§ 40, 46 (18) ; accord, P.A. Stat. Ann. tit. 40, § 899 (1954). Most insurance codes do not contain this clause, although they achieve the same result by simply limiting title companies to single-line underwriting. (A few states still expressly authorize a title insurance company to write mortgage guaranty insurance.)

29. Citations to all states are available in Public Regulation of Title Insurance Companies and Abstracters ch. 6 (Roberts ed. 1961).

30. Of course, a total loss could occur either (1) because the search may have been inadequate or the examination of the abstract may have been faulty, or (2) because a hidden defect was discovered subsequently. Since the first source of total loss is relatively unimportant when compared with the second, the remainder of the paper will refer only to the latter category. With the number of insurance policies increasing at an ever-expanding rate and with assets failing to increase concomitantly, it is the source of total loss which presents the significant danger.

31. A total loss is a loss equal to the face amount of the insured's policy.

32. Johnstone, supra note 4, at 501 & n. 34. See also Gage, op. cit. supra note 10, at 111-14, stating the figure is "not far from . . . 1.5%."
hidden defects ever occur in practice, there is no need for any financial requirement for a sizeable capital or surplus since a title insurer can easily pay all claims out of premium income.

The extent to which an insurance code puts serious emphasis on the probability of a hidden defect leading to a total loss can be measured quite easily by running through the code to find out whether it imposes a maximum single risk on the insurer. Pennsylvania, for example, after setting up capital, surplus and reserve requirements added a maximum single risk provision of this order: no policy could be issued for a single transaction under which liability would exceed an amount ten times the company's capital and surplus.\(^\text{33}\) In practice, therefore, this meant that a company with a capital and surplus totalling $375,000 could lawfully insure the title to a single block of real estate worth $3,750,000. If a hidden defect should occur, however, even the insured above would not be "insured" for more than one tenth the value of the property, while his single claim would wipe out all of the assets of the company, rendering the policies of all of the other insureds absolutely worthless.\(^\text{34}\) More interesting still, most states set no maximum at all on the single risk an insurer may assume.\(^\text{35}\)

The state regulation imposed during the Depression, which for the most part represents the regulation still in effect, assumes that title insurance is not insurance in the sense that the hidden risks "insured" against are totally discounted. The statutes assume that the title insurers deal only in conventional risks common to lawyer-conveyancers and that any losses which ensue will be for overlooked liens on the periphery of the fee itself. Even though the states do not take seriously the possibility of a total loss, the institutional investors that rely on title insurance do. The institutional investors regularly impose their own maximum single risk requirement on the title insurers, requiring the company writing the policy to reinsure the risk over a certain amount.

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34. Assuming a claim is filed it would seem that the claimant, having sustained an actual loss, would have a priority to the reserves of the company vis-à-vis the mass of policyholders who as yet have no claims whatsoever. This remains an assumption since the liquidation provisions of insurance laws applicable to title insurance companies normally do not provide an answer. See generally STATE REGULATION OF TITLE INSURANCE COMPANIES AND ABSTRACTERS § 8.20 (Roberts ed. 1961).
35. Id. § 3.60. Kansas, Maine, New Mexico, North Dakota and South Carolina place a ten per cent of capital and surplus ceiling on risks unless reinsurance is obtained. In Indiana a company is subject to a similar ceiling if it is organized as a casualty company writing title insurance but is not subject to the limitation if it is organized as a title insurance company per se. Mississippi, Texas, Virginia and Wisconsin limit single risks to fifty per cent of capital and surplus and North Carolina to forty per cent.
with other title insurance companies. Thus Professor Johnstone concluded that:

The practice of reinsurance is nevertheless well developed in the industry, some companies reinsuring all risks over $25,000. This practice is encouraged by the refusal of national lenders to accept policies of small companies that do not reinsure a safe percentage of each large policy they write.\(^6\)

In effect, therefore, the strongest source of regulation over the title insurance industry is a system of unofficial regulation imposed by the primary consumers of the title insurance product.

The fact that private regulation by the real consumers of title insurance was, and is, the only real regulation presents a difficult situation, for the public, particularly the home owner class, is not a party to it. Title insurance is issued in two policies, one for the home owner and one for the lender, each policy protecting the respective interests of each. While paid for by the purchaser, it has been generally true that the lender's policy has been more favorable to him than the owner's policy to the home owner. For example, should the lender be required to take the home owner's rights in the property upon default, it is insured against the possibility that the title might be declared unmarketable. Until quite recently the purchaser was not similarly protected as to marketability. It is, of course, arguable that the risk is much less in the case of a lender because, obviously, there is little chance that he will ever take possession of the property. Nonetheless the difference in treatment has continued to be a sorepoint.\(^7\) Worse, even though the institutional investors were using their leverage as consumers to gain advantages for themselves, the fact remains that they were not interested in regulating rates, since, after all, it was commonly the purchaser who paid for the title insurance.\(^8\)

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37. E.g., id. at 504.
38. For the most part there is no rate regulation worthy of the name other than the requirement that the insurers file their current rates with the insurance commissioner. New York, Pennsylvania and Texas are the only states which make a concerted effort to fix rates on the basis of specific statutory criteria. Public Regulation of Title Insurance Companies and Abstracters ch. 7 (Roberts ed. 1961). But see the new Pennsylvania statute, Pa. Laws 1963, act 439, § 739, which reads:

(a) In making rates, due consideration shall be given to past and prospective loss experience, to exposure to loss", to underwriting practice and judgment, to the extent appropriate to past and prospective expenses, including commissions paid to agents and applicants for title insurance, the expenses incurred by title insurance companies, to a reasonable margin of profit and contingencies, and to all other relevant factors both within and outside this Commonwealth.
(b) Rates shall not be inadequate or unfairly discriminatory, nor shall rates
Because of the continued use of title insurance by the institutional investors during the depression, the industry survived 1929. Then, with the Second World War and the ensuing boom, the title insurance industry appeared to prosper. Indeed, some of the figures quoted illustrate an almost fantastic growth.

The title insurance industry, having grown gradually since its beginnings in the nineteenth century, has increased markedly in national importance since the Second World War. The amount of title insurance written increased from $858,600,000 in 1944 to $2,684,400,000 in 1952. There are over one hundred forty companies in the United States engaged in writing title insurance, over thirty of which write title insurance in more than one State. Premiums written in 1960 amounted to over $130,000,000.\textsuperscript{39}

Not only was volume up, but profits seemed to have soared. Thus it was reported in Barron's, in 1961, that the pre-tax profits of California companies were twenty per cent in a "poor year" and "as high as thirty percent in a good year."\textsuperscript{40} But the picture was not all sweetness and light because the post-war boom did generate reactions unfavorable to the industry from several quarters. Coming as they did from several directions and for various reasons, these forces—antithetical as they were to title insurance—must be considered.

At the very end of the war, the Supreme Court decided that insurance was interstate commerce, a decision which seemed to spell an end

\textsuperscript{39} Complaint, para. 8, United States v. Chicago Title & Trust Co., and Complaint, para. 8, United States v. Kansas City Title Ins. Co., Civil No. 14130-3, W.D. Mo., Nov. 9, 1962. Compare Johnstone, \textit{supra} note 4, at 492-93.

\textsuperscript{40} Willatt, \textit{Title Insurance}, in \textit{Barron's} (Sept. 18, 1961).
to all state regulation. Congress, busy as it was with other concerns, sidestepped the problem of legislating a national insurance code by enacting the McCarran-Ferguson Act, the thrust of which was to delegate back to the several states the burden of regulating the insurance industry. Insurance companies were thereby exempted from the Sherman, Clayton, Federal Trade Commission and Robinson-Patman Acts up to a point. Unfortunately the industry, generally, failed to notice the qualification: the federal laws were still applicable to any insurance company "to the extent that such business is not regulated by the State law."

Given the boom period it seemed that the title insurance industry was not exempt from Mr. Justice Holmes' observation that "competition means combination, and that the organization of the world, now going on so fast, means an ever-increasing might and scope of combination." Chicago Title and Trust Company, for example, started the process in 1954 that today has made it the second largest title insurance company in the country. Having operated primarily in Cook County, the company began by acquiring ownership of abstract companies and smaller title companies in Illinois, until Chicago Title in 1960 was writing over 95 per cent of the title insurance in the state. This was followed in 1957 by the purchase of a substantial stock interest in Lake County Title Company, Indiana, which, ultimately, was dissolved, its assets being transferred to Lake County Title Co., Inc. Similar acquisitions followed in Missouri and Wisconsin, culminating in acquisition of the control of the huge Home Title Guaranty Company of New York. The crisis was reached when Chicago Title acquired substantially all the stock in Kansas City Title. The Justice Department reacted at this point and filed an antitrust action against Chicago Title alleging that its most recent acquisition constituted a violation of section 7 of the Clayton Act. The action is still pending. Its implications, however,

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41. United States v. Southeastern Underwriters Ass'n, 322 U.S. 533 (1944). It is reported that "the entire insurance industry and the state regulatory agencies received a catastrophic shock precipitating an avalanche of fear and uncertainty when the . . . Court handed down [its] epochal decision." 1 RICHARDS, INSURANCE 169 (5th ed. 1952).
43. FTC v. Travellers Health Ass'n, 298 F.2d 820, 822 (8th Cir. 1962), is an illustration that federal jurisdiction still exists where state regulation is not "effective." For a reappraisal of the impact of the McCarran-Ferguson Act in the light of this case, see Wiley, Pups, Plants and Package Policies—or the Insurance Anti-Trust Exemption Re-examined, 6 VILL. L. REV. 281 (1961).
45. United States v. Chicago Title & Trust Co., and United States v. Kansas City Title Ins. Co., Civil 14130-3, W.D. Mo., Nov. 9, 1962; "In 1960, the Senate Antitrust Subcommittee issued a report declaring that states have failed to deal effectively with the mounting mergers in this industry. Of 187 mergers in this industry from 1953 to
can hardly have escaped the industry.

Title insurance companies had become national, of course, by acquiring approved attorneys or abstract companies to act as agents to issue title insurance. From these agencies, the title insurers received only premium income. But Professor Johnstone of Yale in a perceptive article raised the question whether premium income alone was enough. That is, he suggested that the dynamics of the title insurance industry were such that the companies must convert these agencies into title plants.46

Operations-wise, there are two basic kinds of title plant. The most complex and expensive system involves the creation of a facsimile of the public records on the company premises. This is done simply by having the company’s trained personnel copy off the daily entries on the public ledgers and insert the information into the company ledgers. The company’s facsimile registry has two distinct advantages over the public’s original one. First, all of the entries in the private system are collected under one roof whereas the public system includes entries in several different places, such as the registry of deeds, the registry of wills, various tax offices and several court houses. Second, whereas the public records may be indexed rather haphazardly, the company’s facsimile registry is indexed in several different ways with the utmost precision,47 and it may be keyed into a system of electronic data pro-

1957, not one was disapproved by state insurance regulators, the subcommittee noticed.” Wall Street Journal, Nov. 12, 1962, p. 2.

46. Johnstone, supra note 4, at 515. Johnstone actually said: “Heavy title insurance saturation in small towns apparently will require all-inclusive service by an agent or branch office of the insurer, using a title plant.” Id. Payne agrees, noting that “there is a tendency for the following sequence of events to occur: An abstracting plant is set up; it later begins to act as an agent in the writing of insurance; when sufficient volume of transactions can be relied upon, the abstract company is converted into a title company.” Payne, supra note 22, at 37 n. 81. But see Payne, Facilitating Title Practice: Some Ways to Solve Old Problems, 15 ALA. L. REV. 18, 23-24 (1962).

There are two possible reasons why this trend should exist. First, the real profit in title insurance may be derived from the conveyancing work the companies do and not from the insurance that is sold. Certainly in New York City the income derived from “service charges” far outweighs premium income. For example, for the year 1961, the income of the Title Guarantee Company was $2,181,300 on premiums and $6,555,203 on service charges. 2 N.Y. INS. REP. 1072-73 (1962). Second, the companies do fare better loss-wise when they do their own work than when they simply insure a title for an approved attorney. Johnstone, supra note 4, at 501. (This fact might even be the basis for an argument that title companies are better conveyancers than the lawyers.) Be that as it may, this does indicate that companies with sound business sense might prefer title plant operations to agency operations, not out of any mania to monopolize conveyancing but simply because the home-office approach works better.

47. For a detailed description of modern indexing techniques see Report, The Ideal Title Plant, Title News, April 1963, p. 2; Collier, Let’s Build a Title Plant, Title News, January 1963, p. 60; Stamper, A Look at a Title and Abstract Plant, Title News, October 1958, p. 2.
In short, this kind of title plant entails the reforms that ought to have been made in the public sector years ago. A less expensive method of title plant operation involves nothing more than the filing of past searches and examinations of titles upon which insurance has been issued. In the event a new owner applies for title insurance on the same premises the existence of those files shortens considerably the work involved, the file affording a place to start and the job then being reduced to one of merely bringing the file up to date.

Putting two and two together, an astute lawyer could have imagined the day when the local abstract company, which also sold title insurance as an agent for a title insurance company, would be acquired by one of the urban title companies and converted into a local title insurance company. Then, replete with a file of abstracts and insurance policies, the new institution would need only to hire a few lawyers to become a city-style conveyancing plant. Given the loss of the conveyancing business in the cities and the tendency of the title companies to buy up abstract companies and convert them into title companies, the lawyer's fear was a reasonable one. The result was a series of lawsuits brought by various bar associations against title companies or their outlets whenever any of them had begun to do conveyancing.

Still other lawyers began to reason that the best way to fight fire was with fire. Thus a group of lawyers in Florida organized a title insurance device of their own, the Lawyers' Title Guaranty Fund. The Fund is a business trust established by fourteen hundred members of the

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48. Chicago Title and Trust Company, for example, has installed electronic equipment capable of storing and retrieving information about all matters affecting the title to more than 1,300,000 pieces of real estate in Cook County. Title News, July 1961, p. 38. Title Insurance and Trust Company of Los Angeles has a computer which can carry on magnetic tape the tax data pertaining to 1,800,000 parcels and can regurgitate this information at the rate of 900 printed lines a minute. The Age of Electronics, Title News, May 1962, p. 12.

49. The ability of the title companies to put the records in order has not gone unnoticed. E.g., Payne, Facilitating Title Practice: Some Ways to Solve Old Problems, 15 Ala. L. Rev. 18, 33 n. 23 (1962):

Among those who have laid greatest stress upon the alleged "impossibility" of creating any adequate system of public records have been the title insurance representatives. Although they have insisted that nothing better than a system devised shortly after the Revolution is suitable for our court houses, they have insisted upon the most modern electronic equipment for their own establishments.

50. Ibid.

Florida Bar to conduct a title insurance business. Administered by a board of fifteen member trustees, the Fund issues title insurance policies written by its members, who must be members of the Florida Bar. An initial contribution of $200 by each member is provided for expenses and the inception of a reserve for losses. Additional funds in the form of premiums are, of course, received when the members write policies for their clients. Receipts from each member are credited to his account and expenses are allocated at the end of every year on the basis of contributions made. Losses on policy claims are treated as ordinary expenses with the exception of losses occasioned by a member's negligence, which are charged against the member's account. Credit balances standing in the Fund for more than seven years, the local period of adverse possession, may be withdrawn by the members.

If all of this were not enough, rumors began to circulate the industry itself to the effect that some title insurance companies had ceased searching and examining titles and were operating on a casualty basis. If true this meant that if the scheme failed to work, these companies were courting insolvency. In turn, assuming a series of company failures, the whole idea of title insurance would become suspect to its

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52. Atkins, Lawyers' Title Guarantee Fund, 21 FLA. L.J. 215 (1947); Carter, A New Role for Lawyers: The Florida Lawyers' Title Guarantee Fund, 45 A.B.A.J. 803 (1959); Carter, Lawyers' Title Guarantee Fund, 8 U. FLA. L. REV. 480 (1955). The fund is not the same thing as a title insurance company incorporated on the lines of a commercial insurance company, where the stock is owned by members of the bar. Presumably a commercial company, notwithstanding the identity of its owners, is subject to the insurance laws of the state on a par with any other insurer. In Florida the statutes require the business trust established by lawyers to meet the "other applicable requirements" of the code. FLA. STAT. ANN. § 609.04 (1956).

53. A title insurance company begins casualty underwriting when it omits the actual search and examination stage from its program and simply prepares a deed and issues title insurance to the vendee of real estate. The theory behind it is that out of both the insurance premium and the rest of the package charge, now that overhead has been all but eliminated, a sufficient reserve can be accumulated after profits with which to pay losses as they arise. Since no one has tried it, or at least admitted publicly to having tried it, there is no basis upon which to calculate whether the losses would or would not exceed the income of the company. Such an experiment would change completely the conception of a title insurance company from its position now as a solvent conveyancer into one as a possibly solvent issuer of deeds without searches and examinations of titles. As of the moment, at least, the consensus is that such a scheme would not work, at least if the charges of the casualty company were going to be kept competitive with those of the conventional companies. See Johnstone, supra note 4, at 516. It is interesting to note that Johnstone warned that this development should be "watched with care." Ibid. See also Note, supra note 4, at 1165.

Some companies are engaged in a modified form of casualty underwriting. This occurs when they discover a serious defect in the claim of title but do not except it from policy coverage. This means that the exceptions in a title insurance policy do not necessarily afford a true picture of the title's limitations. Based on hearsay evidence, it appears that this practice is widespread. If it continues investors will not be able to rely on the existence of title insurance as evidence of clear title and the very raison d'être of the device will disappear.
principal consumer—the institutional investor—who would begin investigating other methods of title assurance. That the idea would not work is premised, of course, on the theory that the losses incurred by insuring titles blindly would exceed income derived from charges fixed at rates competitive with current title insurance costs. As of now it seems to be agreed generally that the idea is unsound and will result in another fiasco reminiscent of the New York mortgage guarantee companies.  

At the moment, therefore, the title insurance industry finds itself being enjoined by lawyers when it attempts to institute urban title company practices in new areas, and where it has succeeded in building itself up in urban areas it finds that success has served only to create antitrust problems. Not only is it faced by law suits in areas where it is still seeking to gain a foothold and in some where it has allegedly acquired a stranglehold, it is now faced with a competitive device created by lawyers to counteract the whole idea of commercial title insurance, while within the ranks of the industry itself the seeds of its own ruination may be germinating in the form of casualty underwriting. At the same time there exists no coherent system of state regulation to assure the continued financial reliability of the industry. Witness to all this, moreover, is the public which pays for title insurance. The question must perforce become: can the traditional systems of state regulation provide enough answers to the travails of the title insurance industry in order that the mass of policyholders can be assured that in fact they are insured and, witness the growing problems in the industry, that they will continue to be insured?

THE REGULATION OF TITLE INSURERS RECONSIDERED

1. Preliminary Problems.

The difficulty with devising a coherent system of state regulation of title insurance companies is rooted in the fact that the task is not simply one of drafting rate schedules and extrapolating controls over underwriting practices. Before any drafting is done the position of the commercial title insurance company in the conveyancing sector must be settled upon. First, one must deal with the problem of conveyancing vis-à-vis the state bars, deciding either to permit or to prohibit insurers' conveyancing. Second, the problem of the lawyers' guaranty funds must be squarely faced: are they to be regulated on a par with the

commercial insurers or are they to be, alternatively, immune from regulation or subject to their own special regulations?

The question of the lawyers' guarantee funds perhaps ought to come first since, after all, most insurance codes begin with definitions. In defining "title insurance" and "title insurers" the accepted definition includes the funds within the group of things to be regulated by the insurance laws. To omit the lawyers' funds from regulation along with the commercial insurers, therefore, will require either a new definition of title insurance or an exemption clause. If these funds are unregulated, they might be tempted to set premiums at a hazardously low level in order to gain control of the market for title insurance. For after all, the purpose of the funds is to compete for the lion's share of the conveyancing dollar. From the point of view of the public interest it is difficult to see why lawyers, who have a stake in the market principle, should enter the business of insurance with any higher or lower susceptibility to taking risks prejudicial to their insureds' interests than any other segment of the community. Further, as profit is being derived from the funds, it is difficult to see why the rates set by the members of the funds are any less a matter of public concern. It would seem to follow, therefore, that the fund must be included within the ambit of any rational scheme of public regulation.

This conclusion necessitates rewriting certain basic concepts of insurance regulation. This is so because most codes are based upon the organization of the insurer as a business corporation with an initial paid-in capital and surplus. In order to accommodate the funds, there-

Title Insurance means insuring, guaranteeing or indemnifying against loss or damage suffered by owners of real property or by others interested therein by reasons of liens, encumbrances upon, defects in or the unmarketability of the title to said real property; guaranteeing, warranting or otherwise insuring the correctness of searches relating to the title to real property; and doing any business in substance equivalent to any of the foregoing in a manner designed to evade the provisions of this article.

56. See note 52 supra.

57. The fund advocates have made no bones at all about the fund being an economic weapon. "It has been estimated that there is between one and one half and two billion dollars a year in title work in the United States. Who should have the work and receive the income—lawyers or corporations?" Carter, A New Role for Lawyers: The Florida Lawyers' Guarantee Fund, 45 A.B.A.J. 803, 806 (1959). This war cry seems part of the standard argument in favor of the funds. E.g., Rush, Title Assurance—A Bar Responsibility, S.D.B.J., July 1963, p. 38, 43. Indeed one of the arguments against the fund is premised on the idea that it is somehow unseemly for lawyers to enter the market place quite so openly. Spencer, Title Insurance, 1962 Mass. L. Q. 399. (It should be noted that the author of this article is chairman of the board of a title insurance company.) As to the problem of ethics involved in selling a client title insurance, whether commercial or fund type, see: A.B.A. Standing Committee on Professional Ethics, Formal Opinion 304 (Feb. 1962).
fore, provision would have to be made to permit the insurance commis-

sioner to license a business trust to write title insurance if the initial
assets of the trust matched in size the assets of the regular insurers,
and in so far as reserves, rates and other provisions of the code were
concerned, if the trust continued to meet the requirements of the insur-
ance laws for the protection of the public.

When it comes to defining the powers of commercial title insurers
the conveyancing question must be faced. This, however, is a knotty
problem in itself because it is not simply a question of statutorily auth-
orizing or prohibiting the companies from dealing in the conveyancing
trade as well as insurance. First, in no state do the companies effect
all the conveyancing. Rather, in urban areas of some states the com-
panies tend to do a considerable amount of the conveyancing in trans-
actions in which they are the insurer. Thus, even in the so-called “title
insurance states” considerable variance exists between practices in the
urban, suburban and rural counties. Second, even if a solution were
built into the statute, there is some doubt whether the legislature would
have the last word, because a number of courts have ruled that the
regulation of what is or is not authorized practice of law is a judicial
question.8

The solution to this problem is probably to be found in a clause
broad enough to authorize conveyancing if that be the accepted practice
in the area, and yet narrow enough so that a court might construe it so
as not to authorize conveyancing. The courts would thereby be able
to decide the question on the basis of statutory interpretation, without
lecturing the legislature about which organ of government is the ultimate
arbiter of this question. For example, such a clause might read: “Every
title insurer shall have the power to make insurance of every kind per-
taining to or connected with titles to real estate and to make, execute and
perfect such and so many contracts, agreements, policies and other instru-
ments as may be required therefore.”9 This clause has the added ad-

vantage that, granting prudence, the title insurers and the bar can meet
to work out an accommodation between themselves—county by county
if necessary—in order to avoid litigation.10 What it lacks in artistic
form, therefore, it more than makes up for in providing a practical ve-

hicle for a solution of this problem.

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8. See New Jersey State Bar Ass'n v. Northern N.J. Mort. Ass'n, 32 N.J. 430,
162 A.2d 257 (1960), and cases cited therein.
10. E.g., New Jersey State Bar Ass'n v. Northern N.J. Mort. Ass'n, 34 N.J. 301,
At long last the pure insurance problem may be faced. Given public protection as the object of insurance regulation, the underlying problem is to decide "how" the public is to be protected. But in order to decide on the law, one must first determine "what" public interest is being protected. That interest is really an intangible: it is the sense of security the public derives from paying premiums to insurance companies which in turn assume certain risks. If these risks materialize they will not spell ruin for the insured because the insurer will pay for the loss and, in so far as money will do it, put the insured back on his feet again. Indeed, since the idea that "they will pay" is the source of this sense of security, it is the public's ultimate concern to know that they can pay. The key to regulation, therefore, is assurance to the public that its security urge is not misdirected.\(^1\)

By and large, we have seen that the typical insurance code requires a title insurance company to be formed as a stock corporation with a paid-in capital of $250,000 and a paid-in surplus of $125,000. In addition, as insurance against a business failure, the company has to create a reserve which could be used to purchase new insurance for its clients. At this point, however, most codes cease to concern themselves in any detail with title insurance companies. Thus this question naturally arises: how effective would these regulations be if the company insured one title for an amount in excess of its assets and reserves and the title failed? Certainly the claimant on this policy ought to be entitled to levy on the assets attributable to capital and surplus and, perhaps, the reserve as well. This could lead to two startling revelations. The assets of the company might turn out to consist primarily of its title plant, the sale value of which might be seriously impaired in the case of a company going out of business because of errors in its title records. Even if the claimant did survive whole, however, the rest of the insureds would find themselves holding absolutely worthless policies. Such a state of affairs could not happen, say the insurers, for no title company could write such a large policy because, in turn, no institutional investor would accept it. As a practical matter, this rejoinder is true as far as it goes, but it is not foolproof.

Let us suppose that a bank owns the controlling stock in a title insurance company and that the bank is lending heavily on the security of a large parcel of urban property. The bank is protected by title

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\(^1\) For the only good article on this whole problem see Kimball, The Purpose of Insurance Regulation: A Preliminary Inquiry into the Theory of Insurance Law, 45 MINN. L. REV. 471 (1961).
insurance, for which the insurer received a large premium. Prudence dictates that the policy is so large that the risk above a certain amount ought to be reinsured with other companies. Yet if the title appears clearly to be a good one, the bank might be tempted not to demand re-insurance, since the premiums—apparently a windfall—will then be retained in full by its title company. Thus the so-called institutional investor may not always be relied on to force its title companies to limit its risks, due to its financial interest in the insurer. In our hypothetical, moreover, as long as the loan does not exceed the assets of the insurer, the bank is protected. It is only the public at large who may have also insured with the title company which is jeopardized by such a transaction.

Even as to institutional investors present on the scene who have no financial interest in the title insurance company, the unofficial regulatory scheme can fail to work. Posit, for example, a developer who buys a parcel of land, subdivides it, and improves it. As a result forty $25,000 houses are sold to forty different purchasers, with more than a dozen lenders being involved. None of the lenders is involved, let us say, in more than several of the mortgage loans for $20,000. Even if astute, the lender may notice no more than that it has several houses for security in the same area, but still the risk involved for such lender is rather small. But (and this is not unusual) what if one local title insurance company writes the title insurance for each sale? Should this occur more than forty small risks are involved, because the developer bought the land from one grantor: the total risk riding on this common origin of the forty titles now totals one million dollars. Again the public is in jeopardy because, unless the officials of the insurer are remarkably conscious of their duties, nothing prevents them from carrying a single risk sizeable enough to wipe the company out should a hidden defect materialize! This is so because, with the individual loans spread among several lenders, the several risks do not appear out of the ordinary when viewed separately. Worse, even in those few states which purport to regulate maximum single risks, the statutes apply only to the several sales, not the ultimate risk inherent in the common origin of the title pre-dating the several sales. If institutional investors take seriously the possibility of hidden defects leading to total losses,62 and if the industry itself is beginning to take them seriously,63 it follows

62. See text accompanying note 36 supra.
63. "I must note that there are increasingly large losses in our industry, but these generally are caused by fraud, embezzlement, improper management or violation of instructions by agents." Burlingame, The Making of a New Title Insurance Code, Title News, January 1963, p. 106, 112.
that, rather than relying on the industry itself to regulate this problem, the state must take a hand, particularly if the validity of all the other financial controls imposed by the state hinge on how this problem is handled.\textsuperscript{64}

In order to regulate the title insurance industry properly, therefore, changes would have to be made in all fifty states. These changes would entail the creation of a coherent set of regulations tailored to the rather unique specifications of the title insurance industry. This would not be an impossible task, however, keeping in mind the nature of the industry to be regulated. A coherent code could be based upon the present requirement, nearly universal, that a title insurance company be a stock corporation with a paid-in capital of $250,000. The company also ought to have an initial paid-in surplus of $125,000. While such a surplus is often required in the current codes, the nature of this surplus is not always clear, particularly since some states require it to be maintained, others do not require it to be maintained, and, interestingly enough, some codes leave the question in doubt.\textsuperscript{65} Properly considered this surplus should be paid-in but need not be maintained. Rather than being just another increment of capital, paid-in surplus plays a distinct role in title insurance regulation. That is, the fund provides a source out of which losses can be paid during the initial period of doing business, providing a buffer over and above the capital pile and a substitute for reserves not yet in existence.

As the company begins to write insurance it is not uncommon to find that it is required by statute to segregate a part of the premiums received into an "uneearned premium reserve." Typically this portion of premium income for any given calendar year is carried as a reserve for twenty years, the common period of adverse possession, and then released into income. It is not included in taxable income until the year in which it is released. In the event of a series of disastrous losses which absorb all the other assets of the company, this reserve can be used to purchase new insurance for all of the outstanding policyholders of the company. This assumes, of course, that the claims for actual losses do not eliminate the reserve as well and that, if the reserve is left intact, another insurer can be found willing to take over the mass of outstanding risks of the insurer that failed. The idea of such an emer-

\textsuperscript{64} The requirements of minimum capital, surplus and reserves are all meaningless unless the insurer is limited to the size risk it can underwrite. Otherwise one loss could eliminate the company and, vis-à-vis the other policyholders, these other financial requirements could be made to appear ludicrous.

\textsuperscript{65} \textit{Public Regulation of Title Insurance Companies and Abstracters} § 6.30 (Roberts ed. 1961).
gency reserve is sound, however, provided other measures are taken to
insure that: (1) an actual requirement to apply the reserve to satisfy
loss claims is a remote possibility and (2) should the need to reinsure
arise, the reserve will exist in fact.

Granting that the reserve is a useful backstop in the event of dis-
aster, the practical problem of deciding how much of the incoming flow
of premium income ought to be allocated to the reserve is not resolved.
A number of states including Florida, Indiana and Ohio have settled on
ten per cent. New York and Pennsylvania—leaders in insurance regu-
lation—have instituted complex mathematical formulae which boil down
to a figure nearer four per cent. While this latter figure matches the
year by year loss experience in the two eastern states, it certainly does
not justify itself as an unearned premium reserve figure. Indeed, it
would seem that ten per cent is a preferable figure, as the unearned
premium reserve should not be used to pay commonplace claims for
overlooked liens and the like—the normal losses suffered by title insur-
ance. Instead, the companies ought to be required to set up a loss re-
serve computed by applying the average percentage of losses being suf-
f ered to the current level of premium income. While sometimes required
in principle, no code contains criteria by which this loss reserve can
be computed. Thus, reason would seem to dictate that the Pennsylvania
formula be put to use by requiring its application to a loss reserve.

In ascertaining the size of the unearned premium reserve, different
considerations pertain, however. Since it would be used only when
several total failures of title or an inordinate series of smaller claims
had consumed the other available assets of the company, there seems to
be no reason to measure it by normal loss expectancy. Granting, more-
over, that the reserve is no guarantee that the other insureds will be
reinsured anyway, it would seem that a higher figure of ten per cent
affords a better chance that another insurer can be induced to assume
those outstanding risks.

The task now is to reduce the likelihood that the unearned premium
reserve will ever have to be put to the test. As a minimal objective,
therefore, there ought to be devices to insure that there are sufficient
assets on hand to pay several total losses on large policies without
jeopardizing the existence of the unearned premium reserve. The max-

66. Id. § 6.50.
67. Ibid. The new Pennsylvania title insurance code continues the old formula:
“every title insurance company shall add to its unearned premium reserve, in respect to
each policy . . . a sum equal to one dollar ($1) for each such policy . . . plus ten
cents (10c) for each one thousand dollars ($1,000) face amount of retained liability. . . .” Pa. Laws 1963, act 439, § 715(b).
imum objective, of course, would be to insure that the title company could survive several total losses without going out of business so that the problem would never arise. The problem, therefore, is to construct an integrated statutory system that will channel the insurers' activities in such a way as to guarantee the optimum survival capacity.

Several steps are in order if this end is to be achieved. The first of these is to make certain that "capital" is a meaningful concept in the sense that the company does have hard assets.\(^{68}\) This can be done only by issuing detailed regulations specifying the investments open to minimum capital, limiting them to the calibre exacted of life insurance companies for the investment of their capital. In particular the files of past researches denominated as the "title plant" ought never be attributed to capital. True, the title plant is a tremendously valuable asset of the going concern; yet it does not follow that the title plant of a defunct company would bring much on the market, particularly if failure of the company was due in part to errors in the search and examination of titles. Treated in this way "minimum capital" can become a kind of auxiliary reserve against disaster.

If a company is going to continue in business it must be able to pay a total loss out of assets other than those attributable to minimum capital. The key, therefore, is to encourage management to build up a surplus\(^ {69}\) out of which losses can be paid in the event they exceed the loss reserve. At this point the maximum single risk limitation enters the picture, not only as a police measure to prevent underwriting of excessive risks, but as a mechanism to encourage the creation of even larger surpluses. Can this be done simply by limiting single risks to "an amount equal to net assets, less an amount equal to the sum of minimum capital, unearned premium reserve, loss reserve and title plant?"\(^{70}\)

A few figures may help clarify this rather unusual formula. Take a small concern with $250,000 invested in the securities required for minimum capital, the rest of its assets consisting of buildings and other assets worth another $100,000, together with a title plant worth $200,000. Total assets, therefore, are $550,000, but neither minimum capital nor title plant can be included in the calculation of risk assets,\(^{68}\) Hard assets means "hard" in the sense of cash, securities and buildings, i.e., those things one can execute upon to satisfy a judgment in fact and which will not depreciate in value in the event an insurance company encounters financial difficulty. Title Plant is not a hard asset because, given a series of title failures, its book value will turn out to be illusory.\(^ {69}\) Surplus for this purpose is defined as assets less liabilities, reserves, capital and title plant.\(^ {70}\) This has been done in the new Pennsylvania legislation; see Pa. Laws 1963, act 439, § 719.
cutting the figure to $100,000. Granting an unearned premium reserve of another $50,000 and a loss reserve of $25,000 the figure is reduced to $25,000. Thus, unless the company has not merely maintained, but has increased, its original paid-in surplus, it cannot write a policy of much magnitude at all!

Granting that the company increases its surplus to $100,000 it can write single risks at that level. From year to year no problems are to be expected, since ordinary losses can be paid out of that small per cent of premiums annually allocated to the loss reserve. Given the possibility of one hidden defect occurring, the company can survive the total loss without jeopardizing its minimum capital. Given the worst imaginable—three total losses in one year—the company must collapse, but the rest of the policyholders are not completely without recourse. The surplus, the assets attributable to minimum capital and the title plant estimated to be worth only half its original value are still equal to or greater than the total of the three losses, leaving the unearned premium reserve intact.

This approach, now in force in Pennsylvania, works well enough in the instance of a typical title insurance company, but it collapses completely in the instance of a huge company with nonstatutory capital and surplus worth several millions. This is so because it can assume a single risk of such magnitude that it cannot survive one total loss without jeopardizing the minimum capital and the unearned premium reserve. This means, then, that—under the formula above— as the size of the company is increased the protection afforded to the policyholder is decreased in the event a hidden defect matures, leading to total losses! This objection can be remedied readily enough by making sure that the company does not undertake risks sizeable enough to jeopardize its capacity to suffer three total losses without eliminating the unearned premium reserve fund. Hence the statute should read: no single risk shall exceed an amount equal to net assets, less an amount equal to the sum of its minimum capital, unearned premium and loss reserves and the value of its title plant; provided, that this amount does not exceed one third of all net assets less reserves.

Not only must the amount of a single risk be limited, the nature of what constitutes a single risk has to be defined. In order to avoid the possibility of a number of separate risks suddenly merging into one risk because each separate risk is derived from a common grant, some kind of geographical risk control must be instituted. Thus, just as

71. See note 70 supra and accompanying text.
fire insurance companies will not insure entire city blocks, so too title companies must not insure separate risks derived from a common grant- or when the statute of limitations does not afford protection against losses attributable to hidden defects in the parent chain of title.

Further, this entire approach assumes that the insurer is searching and examining titles in order to eliminate risks. The introduction of casualty underwriting, therefore, would render whatever security the public gains by this scheme totally meaningless. It follows that some methods must be devised to insure that the companies are not in fact engaged in casualty underwriting. By requiring the companies to keep records of the searches and examinations of titles underlying their insurances thereon, and authorizing the insurance departments to inspect the companies' records, the states will have taken sufficient precautions to cure this evil should it arise.2 Again, however, regulation of this kind is almost totally absent from the current scene.

Two more things, however, need to be regulated, both being now inadequately regulated almost everywhere. These are the problem of mergers and corporate acquisitions and the problem of rates. Both may be omitted from this study—rates because it is worthy of a major study in its own right, and mergers because they do not directly concern the public as much as they do the industry itself. But the threat of federal intervention has had one pronounced effect in that it has made the industry itself aware of the need for regulation at the state level. The time may be propitious, therefore, to capitalize upon the industry's fear of federal control to initiate new legislation at the state level, if the regulation is geared to the public need as well as private exigencies, whether the private interest be that of the title insurer, the conveyancing bar or the lawyers' funds.

72. Again, this was done in Pennsylvania; see Pa. Laws 1963, act 439, § 707.